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IN THE

Supreme Court of the United States

JERRY SUMMERS, GEORGE T. LENORMAND, JEFFERY D. CRITES, LOUISE VAN RAENSBURG and JAMES E. SHAMBO, individually and on behalf of all others similarly situated,

Petitioners,

v.

STATE STREET BANK & TRUST COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. What is the proper standard for determining whether a fiduciary of an employee stock ownership plan ("ESOP") subject to the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. §§ 1001, *et. seq.*, breached its fiduciary duty of prudence by failing to diversify that ESOP's investment in employer stock before that stock lost all or most of its value?

2. Is the applicable standard different when the fiduciary is a "directed trustee" within the meaning of 29 U.S.C. § 1103(a)(1)?

PARTIES TO THE PROCEEDING

In addition to the parties identified in the caption, the following are parties to the case (and are all defendants who have previously settled all claims against them): UAL Corporation ESOP Committee, Marty Torres, Barry Wilson, Doug Walsh, Ira Levy, Don Clements, and Craig Musa.

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Petitioner respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS AND JUDGMENTS BELOW

The opinion of the Seventh Circuit (Pet. App. A) is reported at 453 F.3d 404 (7th Cir. 2006). The opinion of the district court (Pet. App. B) is not reported but may be found at 2005 U.S. Dist. Lexis 23918 (N.D. Ill. Oct. 12, 2005).

JURISDICTION

The opinion and judgment of the Court of Appeals was issued on June 28, 2006. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTES AND ADVISORY BULLETIN INVOLVED

Statutes at issue in this case include the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1103, 1104, 1105, 1109, 1132 (Pet. App. C, D, E, F, and G). Also at issue is Department of Labor, Field Advisory Bulletin 2004-03 (Pet. App. H).

STATEMENT OF THE CASE

This case is a class action brought on behalf of thousands of individuals who were participants in the United Airlines Corporation Employee Stock Ownership Plan ("United ESOP" or "the Plan") during the period from November 17, 2001, through June 30, 2003.[1] In this case, Petitioners/ Plaintiffs allege that the fiduciaries of the United ESOP, including State Street Bank & Trust Company ("State Street"), breached their fiduciary duties to the Plan and its

1. R.Doc.# 178, Plfs' Add'l Facts, ¶ 1, and Exs. A-E (Class Representative Declarations) attached thereto, Appellants' App., Tab B.

participants by failing to diversify the Plan's investment in the stock of United Airlines ("United," or "UAL") even though State Street knew that United faced extreme financial problems and a significant risk of bankruptcy. Despite unmistakably clear and unusually candid warnings from United's CEO on October 17, 2001, and repeated warnings about the company's viability over the next 10 months, the Plan's fiduciaries took no action to diversify the Plan's investments. Even after State Street concluded that there was a "high risk" that UAL would not qualify for the government loan guarantees that the Company needed to survive, State Street continued to do nothing to protect the Plan and its participants from UAL's plunge into bankruptcy that essentially wiped out the Plan's assets.

The United ESOP was an employee stock ownership plan, or "ESOP", maintained pursuant to the Employee Retirement Income Security Act of 1974 (ERISA), and was "designed to invest exclusively in shares of [United's] stock."[2] Participants in the United ESOP were prohibited from diversifying their accounts under the Plan except upon a termination of employment or the satisfaction of certain age and length-of-participation requirements.[3] Instead, the direction of the United ESOP's investments was overseen by the Plan's fiduciaries: the ESOP Committee, which was the Plan's named fiduciary,[4] and State Street, which was the

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2. R.Doc.# 178, Plfs' Add'l Facts, ¶ 17 and R.Doc.# 184, Plfs' Ex. 39.

3. R.Doc.# 178, Plfs' Add'l Facts, ¶ 12 and R.Doc.# 184, Plfs' Ex. 39.

4. R.Doc.# 178, Plfs' Add'l Facts, ¶ 2 and R.Doc.# 184, Plfs' Ex. 39.

trustee for the Plan throughout the relevant time period.[5] With respect to these fiduciaries, the Plan provided that "every individual who is a fiduciary with respect to the Plan shall exercise his responsibilities with respect to the Plan in a manner consistent with ERISA and other applicable laws."[6] Similarly, the Trust Agreement provided that "the Trustee shall not be obligated to follow the direction of a named fiduciary unless such direction is ... proper within the meaning of Section 403(a) of ERISA and is not contrary to ERISA."[7]

Despite holding those fiduciary duties under the Plan and the Trust Agreement, State Street did not begin diversifying the United ESOP's investment in United stock until September 27, 2002,[8] on the eve of United's bankruptcy. However, it had been well-known to State Street for at least a year prior to that date that United was in serious financial trouble. In early 2001, it was already apparent that United was facing difficult financial prospects in the year ahead. United stated in its Form 10-K for 2000 that the "Outlook for 2001" was poor due to a decrease in business travel, rising fuel costs and other factors.[9] The prediction was accurate. In the first six months of 2001, United reported operational losses of $860 million, compared with earnings of $858

5. R.Doc.# 178, Plfs' Add'l Facts, ¶ 4 and R.Doc.# 184, Plfs' Ex. 21.

6. R.Doc.# 178, Plfs' Add'l Facts, ¶ 18 and R.Doc.# 184, Plfs' Ex. 39.

7. R.Doc.# 178, Plfs' Add'l Facts, ¶ 20 and R.Doc.# 184, Plfs' Ex. 21 at § 3.8.

8. R.Doc.# 178, Plfs' Add'l Facts, ¶¶ 171-72 and R.Doc.# 184, Plfs' Ex. 25 at UAL-SUM 00123-24.

9. R.Doc.# 178, Plfs' Add'l Facts, ¶ 38 and R.Doc.# 184, Plfs' Ex. 46.

million in the first six months of 2000.[10] On July 19, 2001, United stock closed at $34.42.[11] On September 10, 2001, United stock closed at $30.82.

United stock was thus already losing its luster when the catastrophic events of September 11, 2001, occurred, shaking the American economy and hitting the airline industry particularly hard. When the stock market re-opened on September 17, 2001, United stock closed at $17.50.[12] By September 20, 2001, Bloomberg News carried reports that United and other airlines were "seeking $17.5 billion of government aid to stave off bankruptcy."[13]

However, the clearest sign of where United was headed came on October 17, 2001, when United's CEO, Jim Goodwin, wrote an extraordinary letter to all United employees, a copy of which was filed with the SEC as an 8-K. According to that letter:

> Prior to Sept. 11, all of the major U.S. airlines were having financial difficulties as a result of the weakening economy. The economic pain was worse for us because we rely more heavily on frequent business travelers for our business than they do. . . .
>
> Then came Sept. 11.

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10. R.Doc.# 178, Plfs' Add'l Facts, ¶ 42 and R.Doc.# 184, Plfs' Ex. 40 (10-Q for 2Q 2001).

11. R.Doc.# 178, Plfs' Add'l Facts, ¶ 40 and R.Doc.# 184, Plfs' Ex. 50.

12. R.Doc.# 178, Plfs' Add'l Facts, ¶ 44 and R.Doc.# 184, Plfs' Ex. 50.

13. R.Doc.# 178, Plfs' Add'l Facts, ¶ 46 and R.Doc.# 184, Plfs' Ex. 51.

> In the wake of that day's horrific events, we are in nothing less than a fight for our life. Never in our 75-year history have we faced an economic challenge of this magnitude, where the drop-off in air travel has been so unexpected and prolonged.
>
> Our number one priority now is to get United into a financial position that will allow us to continue operating. We are not there yet. To get there, we must focus on breakeven cash flow. That means being in the position where we have as much money coming into our bank account as we have streaming out of it. In the past, we struggled to make a profit. Now we're in a struggle just to survive.
>
> * * *
>
> Let me illustrate the financial hole we're in. Before Sept. 11th, we were not in a comfortable financial state, with costs exceeding our revenue on a daily basis. Today, the situation is exacerbated with costs exceeding revenue at four times the pre-Sept. 11 rate. Today, we are literally hemorrhaging money.
>
> Clearly, this bleeding has to be stopped – and soon – or United will perish sometime next year. . . .[14]

At the time of the letter, United was burning cash at a rate of $15 million per day.[15] The company had lost $1.6

14. R.Doc.# 178, Plfs' Add'l Facts, ¶ 47 and R.Doc.# 184, Plfs' Ex. 32, Appellants' App., Tab D.

15. R.Doc.# 178, Plfs' Add'l Facts, ¶ 61 and R.Doc.# 184, Plfs' Ex. 41 at P 0050.

billion for the three-month period ending September 30, 2001, and $2.2 billion for the nine month period ending that same date.[16] On the two market days following the release of the Goodwin letter, United stock dropped more than 20%, closing at $15.05 on October 18, 2001.[17]

Goodwin resigned on October 28, 2001, but the prospects for the company remained dire. The Buckingham Research Group ("Buckingham") stated the resignation "will probably not stave off the inevitable. After hitting new lows last week, we believe that UAL's share price is starting to reflect a possible Chapter 11 filing." The Buckingham report noted that employees "do not want to grant concessions," yet "[w]ithout those concessions there is no way this company can survive."[18]

The warnings about United's likely bankruptcy were numerous and dire, and they continued for the next several months. The public information included the following:

> November 2, 2001: Solomon Smith Barney reports that labor costs and work rules were "UAL's Achilles heel," and that "reorganization risk is material."[19]
>
> November 12, 2001: *Business Week* states that "[i]f UAL continues to bleed red ink, some

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16. R.Doc.# 178, Plfs' Add'l Facts, ¶ 57 and R.Doc.# 184, Plfs' Ex. 41 at P 0042-44.

17. R.Doc.# 178, Plfs' Add'l Facts, ¶ 48 and R.Doc.# 184, Plfs' Ex. 50.

18. R.Doc.# 178, Plfs' Add'l Facts, ¶ 53 and R.Doc.# 184, Plfs' Ex. 61.

19. R.Doc.# 178, Plfs' Add'l Facts, ¶ 54 and R.Doc.# 184, Plfs' Ex. 59.

analysts say bankruptcy – which would allow it to abrogate its union contracts – may be its only hope."[20]

January 2002: Moody's Investor Services downgrades United's unsecured debt ratings to Caa2, reflecting its "view that United's cash flow has deteriorated and that large cash losses from operations in the last few months have eroded UAL's financial profile." Moody's further notes that "the company's high cost base will hamper recovery of adequate cash levels."[21]

January 23, 2002: A Buckingham report states, "We believe that the survivability of this airline in its current form is in doubt."[22]

February 1, 2002: *The New York Times* reports that "Several industry experts and two senior executives at rival airlines said they were beginning to conclude that United ... would have no choice but to file for Chapter 11 bankruptcy protection later this year if it were to have any hope of turning itself around."[23]

February 6, 2002: Morgan Stanley reports: "As most observers of the airline industry know by

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20. R.Doc.# 178, Plfs' Add'l Facts, ¶ 62 and R.Doc.# 184, Plfs' Ex. 52.

21. R.Doc.# 178, Plfs' Add'l Facts, ¶ 117 and R.Doc.# 184, Plfs' Ex. 26 at SSB 00850 (State Street "Watchlist Committee" report dated Jan. 18, 2002).

22. R.Doc.# 178, Plfs' Add'l Facts, ¶ 73 and R.Doc.# 184, Plfs' Ex. 63.

23. R.Doc.# 178, Plfs' Add'l Facts, ¶ 75 and R.Doc.# 184, Plfs' Ex. 54.

now, no carrier that loses the kind of money UAL did in 2001 ($1.8 billion) has ever turned itself around without seeking protection in chapter eleven."[24]

April 2002: United reports first quarter operational losses of $711 million, compared with $391 million in losses in the first quarter of 2001.[25]

May 2002: J.P. Morgan reports: "The market appears to be treating UAL as terminally ill."[26]

June 24, 2002: United's CEO, Jack Creighton, states: "We're now burdened by short-term financing needs that are driven by the aftermath of September 11 and aggravated by the weak economic recovery. While we continue to explore financing alternatives, we don't believe they will be sufficient because our access to the capital markets has been severely restricted."[27]

June 24, 2002: United files for federal loan guarantees, four days before the deadline for doing so.[28] However, the guidelines for such guarantees

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24. R.Doc.# 178, Plfs' Add'l Facts, ¶ 76 and R.Doc.# 184, Plfs' Ex. 64 at SSB 00535.

25. R.Doc.# 178, Plfs' Add'l Facts, ¶ 81 and R.Doc.# 184, Plfs' Ex. 43 at P 0143 (10-Q for 1Q 2002).

26. R.Doc.# 178, Plfs' Add'l Facts, ¶ 86 and R.Doc.# 184, Plfs' Ex. 66 at SSB 00598.

27. R.Doc.# 178, Plfs' Add'l Facts, ¶ 88 and R.Doc.# 184, Plfs' Ex. 37 at UAL-SUM 002138.

28. R.Doc.# 158, Plaintiffs' Response to Defendant State Street Bank & Trust Company's Statement of Facts ("Plfs' Response") at 4-5.

> require that the air carrier demonstrate that it has a "financially sound" business plan and that its creditors, including employees, will make concessions "that will improve the financial condition of the air carrier. . . ." 14 C.F.R. §§ 1300.17(b)(4)(i), (v).
>
> August 14, 2002: UAL announces that, without ATSB loan guarantees, it might have to file for bankruptcy in the fall, and that it would have to obtain concessions from the unions in order to get the loan guarantees.[29]

This situation was well-known to Respondent State Street. In 2001, on its own initiative, State Street monitored United stock through its agent, CitiStreet,[30] and on December 20, 2001, the CitiStreet Watchlist Committee placed United on its Watchlist because of the drop in stock price and the public statements made in the Goodwin letter of October 17, 2001, among other factors.[31] United remained on that Watchlist through September 2002, by monthly vote of the Watchlist Committee.[32]

On May 8, 2002, State Street went so far as to elevate United stock for internal review by its Fiduciary Committee,

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29. R.Doc.# 178, Plfs' Add'l Facts, ¶ 141 and R.Doc.# 184, Plfs' Ex. 26 at SSB 0881 (Watchlist Committee Report dated Sept. 20, 2002).

30. R.Doc.# 17, Plfs' Add'l Facts, ¶ 111 and R.Doc.# 186, Plfs' Ex. 1 (Daniels Dep.) at 17:16-20 and 66:16-20; Plfs' Ex. 2 (Driscoll Dep.) at 30:13-14.

31. R.Doc.# 178, Plfs' Add'l Facts, ¶ 113 and R.Doc.# 184, 186, Plfs' Ex. 23 at SSB 00843, Plfs' Ex. 1 (Daniels Dep.) at 24:3-18.

32. R.Doc.# 178, Plfs' Add'l Facts, ¶ 115 and R.Doc.# 184, Plfs' Ex. 26 at SSB 00848, 00857, 00861, 00865, 00869, 00873, 00877, 00881.

in accordance with its Fiduciary Charter, which provided that "[i]f continued deterioration is noted then the company may be elevated for review to the Fiduciary Committee."[33] At the same time, State Street began consulting with counsel about whether it had an obligation to override the Plan by selling United Stock,[34] and was informed that it had a duty "to disregard the terms of the plan and trust agreement if it determines that it is no longer prudent for the plan to continue to hold the UAL shares."[35]

Significantly, on May 22, 2002, a State Street internal report opines that "there is a high risk that UAL will not be able to come to terms with some of the union employees to accept wage concessions, which jeopardizes the $1.8 billion loan guarantees by the government."[36]

At the same time that State Street monitored United stock and considered its obligations to diversify the Plan's investments, State Street was also fully aware that the named fiduciaries of the ESOP Committee had never discussed United's financial condition or whether it should sell the $1 billion in United stock that the ESOP held.[37]

However, State Street did not take ***any*** action to protect the United ESOP's assets until August 15, 2002, when State

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33. R.Doc.# 178, Plfs' Add'l Facts, ¶ 127 and R.Doc.# 184, Plfs' Ex. 5 (Feely Dep.) at 25:22-26:5; Plfs' Ex. 26 at SSB 00885.

34. R.Doc.# 178, Plfs' Add'l Facts, ¶ 130 and R.Doc.# 186, Plfs' Ex. 12 (Smith Dep.) at 46:5-22, 59:1-2.

35. R.Doc.# 178, Plfs' Add'l Facts, ¶ 131 and R.Doc.# 186, Plfs' Ex. 12 (Smith Dep.) at 44:9-45:3.

36. R.Doc.# 158, Plfs' Response at 5 and R.Doc.# 130 (State Street report).

37. R.Doc.# 178, Plfs' Add'l Facts, ¶¶ 146-147 and R.Doc. # 184, Plfs' Exs. 5 and 25.

Street finally informed United that it had "put United on a 'watch list' due to the decreasing stock price and the possible bankruptcy filing."[38]

A special meeting of the ESOP Committee convened on August 20, 2002, at which time State Street first informed the other fiduciaries of the obligation to review whether it was prudent to retain United stock in the Plan.[39] At a subsequent meeting in late August, State Street was appointed as the investment manager for the United ESOP,[40] and on September 27, 2002, State Street finally began selling the Plan's shares of United stock.[41] On September 27, 2002, the stock closed at $2.36.[42]

According to Petitioners' expert, Daniel R. Fischel, had the fiduciaries commenced selling United stock within 30 days of the October 17, 2001, Goodwin letter and placed those shares in an alternative, low-risk fund, they would have saved Plan participants from approximately $540 million in losses.[43]

Plaintiffs filed suit on behalf of the United ESOP on February 28, 2003, claiming, pursuant to ERISA, 29 U.S.C.

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38. R.Doc.# 178, Plfs' Add'l Facts, ¶ 143 and R.Doc.# 184, Plfs' Ex. 25 at UAL SUM 00047.

39. R.Doc.#178, Plfs' Add'l Facts, ¶ 156 and R.Doc.# 184, Plfs' Ex. 25 at UAL-SUM 00047.

40. R.Doc.# 178, Plfs' Add'l Facts, ¶ 167 and R.Doc.# 184, Plfs' Ex. 25 at UAL-SUM 0080.

41. R.Doc.# 178, Plfs' Add'l Facts, ¶¶ 171-72 and R.Doc.# 184, Plfs' Ex. 25 at UAL-SUM 00123-24.

42. R.Doc.# 178, Plfs' Add'l Facts, ¶ 103 and R.Doc.# 184, Plfs' Ex. 50.

43. R.Doc.# 115, Supplemental Report of Daniel R. Fischel at ¶ 17(2) (attached as Ex. 1 to Declaration of Daniel R. Fischel).

§§ 1109 and 1132(a)(2), that the Plan's fiduciaries had breached their fiduciary duties by failing to diversify the ESOP's investments at an earlier time. All defendants other than State Street settled the claims against them.

On October 12, 2005, less than a week before trial, the United States District Court for the Northern District of Illinois granted summary judgment in favor of State Street, finding that it had not breached its fiduciary duty because it had no duty to sell until there was evidence of an "imminent collapse" by United, a point on which it found no genuine issues of material fact. *Summers v. UAL Corp. ESOP Comm.*, 2005 U.S. Dist. Lexis 23918, *14-15 (Pet. App. B). On June 28, 2006, the Court of Appeals for the Seventh Circuit affirmed the district court's decision. *Summers v. State Street Bank & Trust Co.*, 453 F.3d 404 (7th Cir. 2006) (Pet. App. A).

REASONS FOR GRANTING THE PETITION

The Seventh Circuit's decision in this case created a conflict among the Courts of Appeals regarding the duties of ERISA fiduciaries to diversify employer-stock investments made pursuant to ESOPs. The Seventh Circuit's new standard also conflicts with prior decisions of this Court and touches directly on an important question that is the subject of substantial ongoing litigation in the federal courts. The Court should resolve this conflict to allow that ongoing litigation to proceed in an efficient manner.

In addition, the Seventh Circuit's decision in this case exposes and contributes to a conflict among the Courts of Appeal regarding whether the duty of an ERISA fiduciary to diversify an ESOP's employer-stock investments is lessened when the fiduciary is a "directed trustee" acting pursuant to 29 U.S.C. § 1103(a)(1). Petitioners believe the Seventh Circuit came down on the correct side of this split, but

recognize that the Courts of Appeals are in conflict and that the issue of directed-trustee liability would likely need to be resolved in any opinion by this Court on the merits of this suit. In any event, a resolution of the conflict would set clear standards for ESOP fiduciaries and provide much-needed guidance to lower courts that are presently faced with numerous different opinions as to the proper standard of liability for directed trustees.

I. THE SEVENTH CIRCUIT'S STATED STANDARD FOR ASSESSING WHETHER AN ESOP FIDUCIARY BREACHED ITS DUTY TO DIVERSIFY THE ESOP'S INVESTMENT IN EMPLOYER STOCK CONFLICTS WITH DECISIONS FROM OTHER COURTS OF APPEALS AND PRIOR DECISIONS OF THIS COURT

A. The Seventh Circuit's Decision Created a Conflict on the Previously Settled Issue of a Fiduciary's Duty to Diversify

Prior to the Seventh Circuit's decision in this case, the Courts of Appeals were generally in agreement as to the proper standard for determining whether an ESOP fiduciary had breached the ERISA duty of prudence by failing to diversify an ESOP's investment in employer stock. As originally formulated in *Moench v. Robertson*, 62 F.3d 553, 571-72 (3d Cir. 1995):

> an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision. However, the plaintiff may overcome that presumption by establishing that the fiduciary abused his discretion by investing in employer securities. . . . [T[he plaintiff must show that the

> ERISA fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate.

Until this case, the *Moench* standard had been recognized as the prevailing standard by every Court of Appeals that considered the issue. *See, e.g., LaLonde v. Textron, Inc.*, 369 F.3d 1, 4, 6 (1st Cir. 2004); *Kuper v. Iovenko*, 66 F.3d 1447, 1458-59 (6th Cir. 1995); *Wright v. Oregon Metallurgical*, 360 F.3d 1090, 1098-98 (9th Cir. 2004) (questioning *Moench* standard but applying it). *See also, e.g., In re Polaroid ERISA Litig.*, 362 F. Supp. 2d 461, 474-75 (S.D.N.Y 2005); *Smith v. Delta Air Lines, Inc.*, 422 F. Supp. 2d 1310, 1327-31 (N.D. Ga. 2006); *In re Sprint Corp. ERISA Litig.*, 388 F. Supp. 2d 1207, 1221-23 (D. Kan. 2004). As the Sixth Circuit stated in adopting the *Moench* standard, a plaintiff can rebut the presumption "by showing that a prudent fiduciary acting under similar circumstances would have made a different investment decision." *Kuper*, 66 F.3d at 1459.

However, in the opinion below, the Seventh Circuit acknowledged *Moench* and its progeny, but adopted a new, and unworkable, standard. First, the Seventh Circuit adopted a *per se* rule that a continuous, steep, and unmitigated decline in a company's stock, coupled with evidence that the underlying company continues to hemorrhage money and fails to address the problems causing the decline, can never create a duty to diversify an ESOP's investment in company stock. Specifically, with regard to United, the court ruled that as the stock price of UAL plummeted, "at *every* point in the long slide of United's stock price, that price was the best estimate available either to State Street or to the Committee of the company's value . . . and so neither fiduciary was

required to act on the assumption that the market was overvaluing United." 453 F.3d at 408-09 (emphasis in original).

In other words, the Seventh Circuit ruled that an ESOP fiduciary should never be held to a duty of diversifying an ESOP because the company's stock value was declining and there were strong indications that it would plummet further – and the court so held without considering what those indications were in this case, and it furthermore failed to analyze the intentions of the Plan's settlor. *See id.*

No other Circuit has ever adopted such a *per se* rule, as the *Moench* standard anticipates a review of all of the relevant facts to determine whether a decline in the stock price, combined with available information about the state of the company, meant that the employer stock was no longer a prudent investment. *See Moench*, 62 F.3d at 571-72. *See also Kuper*, 66 F.3d 1447 (considering all facts and determining that plaintiff failed to satisfy burden because the price of the shares "fluctuated significantly" over the relevant time period); *Wright*, 360 F.3d at 1109 (no claim because no allegation or facts indicating that the company's viability was in question); *Lalonde*, 369 F.3d at 7 (concern over inability of company to "survive its downsizing," coupled with a failure to protect the plan's assets, is sufficient to state a claim). This is the preferred approach, as it permits and requires courts to take into consideration all of the facts surrounding the employer's stock, and the prospects for that stock, in determining whether it was a prudent investment for the ESOP in question.

Moreover, the Seventh Circuit further exacerbated this Circuit split when it also ruled that, independent of a plummeting stock price, a fiduciary may nonetheless be held liable for not taking into account the increased risk of

investing in that stock. While this basic concept does not conflict with *Moench* and its progeny, the Seventh Circuit's formulation of its standard does conflict with those decisions.

Under the Seventh Circuit's standard, a fiduciary's potential liability would be based on an ad hoc analysis of the risk borne by individual plan participants. Although the Seventh Circuit did not articulate a clear test, the contemplated analysis has two steps: (1) an assessment of whether risk to the owners of the stock had increased significantly, *see* 453 F.3d at 408-09, and (2) a ***participant-by-participant*** analysis of whether an ESOP participant's other sources of income or retirement savings allowed that participant to absorb the increased risk in the ESOP investment. *See id.* at 409-11.

It is in the second step of this analysis that the Seventh Circuit again departed from the opinions of its sister Circuits. The court indicated that the liability consideration must take into account "the employee-shareholders' total wealth," including their ESOP holdings, "their expected earnings and fringe benefits as employees of United," and the likelihood that the increased risk in United's stock price jeopardized the employees' future employment. *Id.* at 409. As the court further elaborated:

> The tension between the goal of protection against risk and the goal of a portfolio dominated by a single stock is not acute if the participants in the ESOP have adequate sources of income or wealth that are not correlated with the risk of that stock, so that the ESOP is not their primary financial asset. But if they don't have substantial other wealth the goals cannot be reconciled, though they can be compromised by requiring fiduciaries to begin diversifying the ESOP's assets at the point

> at which an increase in the riskiness of the assets . . . would have induced the creators of the ESOP either to have not created it at all or to have required at least partial diversification.

Id. at 410.

Thus, the Seventh Circuit would rest fiduciary liability for failure to diversify an ESOP's investments on a consideration of each plan participant's assets and projected wealth ***outside of the ESOP***. Accordingly, with respect to any plan participant who had significant non-ESOP assets, there would apparently never be any fiduciary duty to diversify that participant's ESOP account – even if the risk in owning Company stock had increased so substantially that the ESOP's creators would not have wished the trustees to retain the stock. The Seventh Circuit's opinion thereby gives rise to the inevitable circumstance in which a fiduciary could be held not liable for failing to diversify the ESOP investments as to one well-heeled participant but liable for failing to diversify the same investment in the same plan for a participant with fewer assets outside of the ESOP.

The conflict between such a standard and the standard adopted by other Circuits is clear. Under *Moench*, the focus of the standard is whether a plaintiff can prove that the state of employer stock had deteriorated to such a degree that it was an abuse of discretion to continue to hold those shares, given the settlor's intent in creating the ESOP. *See* 62 F.3d at 553. The focus is directly, and correctly, on the plan's investment and whether that investment is no longer in accord with the purposes of the ESOP. A fiduciary is either liable to the plan as a whole, or is not. *See also Kuper*, *supra*, 66 F.3d at 1458-60 (focus on prudence of investment of plan assets as a whole); *Lalonde*, *supra*, 369 F.3d at 6-7 (same); *Wright*, *supra*, 360 F.3d at 1098-99 (same).

Moreover, the Seventh Circuit's standard would be impossible to administer. It is unlikely that in actual application of the standard, any court (or any fiduciary attempting to fulfill its duties to a plan) would be able to determine precisely the point at which a particular participant could be deemed as having sufficient outside income or savings that would buffer that participant against the increased risk of an ESOP investment. Any distinction between an individual deemed able to absorb the increased risk and an individual not able to do so would necessarily be arbitrary and would apparently not take into consideration whether the participant *wanted* to carry that additional risk. And perhaps most importantly, that distinction is completely divorced from what should be the key considerations in assessing fiduciary liability: the nature of the investment, the deterioration of that investment, the effect of that deterioration on the ESOP and its relation to the settlor's intent, and the fiduciary's actions or failure to act. The Seventh Circuit's standard is unworkable and in conflict with decisions of the other Circuits. This Court should grant certiorari to resolve that conflict.

B. By Looking to Participants' Assets Outside of the ESOP Trust, The Seventh Circuit's Standard Also Conflicts With Established Law of This Court and the Courts of Appeals Regarding Plan-Wide Relief and Uniform Treatment of Plan Participants

The Seventh Circuit's standard, by looking to assets and holdings of particular participants outside the plan, and by thereby requiring different treatment of similarly situated plan participants, also clearly conflicts with decisions from this Court and the Courts of Appeals which require suits for mismanagement of plan assets to seek plan-wide relief and require fiduciaries to treat similarly situated participants in a uniform fashion.

It has been well-established law for more than 20 years that suits concerning breaches of fiduciary duty brought pursuant to 29 U.S.C. §§ 1109(a) and 1132(a)(2) must be brought on behalf of "the plan as a whole." *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 139, 105 S. Ct. 3085, 87 L. Ed. 2d 96 (1985). As the Court stated, "the entire text [of the statute] persuades us that Congress did not intend . . . to authorize any relief except for the plan itself," and thus suits for individual damages are not permitted under ERISA. *Id.* at 144.[44]

Over the years, the Courts of Appeals have uniformly followed this standard, and required that all suits for breaches of fiduciary duty brought pursuant to 29 U.S.C. §§ 1109(a) and 1132(a)(2) must be brought on behalf of a plan, to the exclusion of suits brought by participants to recover individual damages. *See, e.g., Dobson v. Hartford Fin. Servs. Group, Inc.*, 389 F.3d 386, 397-98 (2d Cir. 2004); *In re Schering-Plough Corp. ERISA Litig.*, 420 F.3d 231, 238-41 (3d Cir. 2005); *LaRue v. DeWolff, Boberg, & Assocs.*, 450 F.3d 570, 573-74 (4th Cir. 2006); *Kuper v. Iovenko*, 66 F.3d 1447, 1452-53 (6th Cir. 1995); *Magin v. Monsanto Co.*, 420 F.3d 679, 687-88 (7th Cir. 2005); *Farr v. US West, Inc.*, 58 F.3d 1361, 1364 (9th Cir. 1995).

The Seventh Circuit's decision in this case is contrary to that rule. The inevitable outcome of that court's new

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44. Subsequent to *Russell*, this Court ruled in *Varity Corp. v. Howe*, 516 U.S. 489, 511-15, 116 S. Ct. 1065, 134 L. Ed. 2d 130 (1996), that individual suits for breaches of fiduciary duty are permissible under § 1132(a)(3) in circumstances where the claims are not covered by 29 U.S.C. § 1109(a), which concerns fiduciary management of plan assets. *Varity* does not apply to suits such as this, which concern the management of plan assets, and are thus subject to § 1109(a) and must be brought pursuant to § 1132(a)(2).

standard will be that some participants will have a claim under § 1109(a) for a fiduciary's failure to diversify an ESOP's investments, while other participants in that same plan will not. *See* 453 F.3d at 410. The Seventh Circuit would apparently require or endorse individual suits for damages under §§ 1109(a) and 1132(a), since no claim for breach of fiduciary duty could be assessed on a plan-wide basis, or at least it would require awards of damages to individual participants rather than to the plan as a whole. That would be contrary to the language and purposes of the statue as construed by this Court in *Russell.*

Similarly, the Seventh Circuit's proposed standard runs counter to the well-established, and common-sense, rule that a fiduciary must administer an ERISA plan in a consistent fashion as to plan participants in similar or identical circumstances. In numerous instances, the Courts of Appeals (including the Seventh Circuit) have ruled that where an ERISA fiduciary applies a plan provision inconsistently to similarly situated participants, those actions are evidence that the fiduciary has acted arbitrarily and capriciously, and that its decision is therefore subject to reversal. *See, e.g., Dennard v. Richards Group, Inc.*, 681 F.2d 306, 314 (5th Cir. 1982); *Russo v. Health, Welfare, & Pension Fund*, 984 F.2d 762, 766 (7th Cir. 1993); *Pilon v. Retirement Plan for Salaried Employees of Great Northern Nekoosa Corp.*, 861 F.2d 217, 219-20 (9th Cir. 1988); *Wagener v. SBC Pension Benefit Plan*, 407 F.3d 395, 404 (D.C. Cir. 2005).

Yet, under the standard outlined by the Seventh Circuit, two plan participants with precisely the same amount of employer stock in their ESOP accounts, who are thus subject to identical risks for identical amounts of money, would have to be treated differently from each other if they had significantly different assets or savings outside of their ESOP

holdings. This is yet another conflict that this Court should resolve to avoid future confusion over the applicable standards.

C. Setting a Uniform Standard Is Necessary Given the Amount of Pending Litigation Concerning These Issues

The questions presented in this petition are not simply esoteric issues limited to this case. To the contrary, the contours of the fiduciary duties owed by ESOP fiduciaries to diversify employer-stock investments is a heavily litigated area of ERISA law. One survey of the scope of such litigation found that

> [a]s of January 25, 2005, there have been approximately ***fifty*** decisions in cases that allege breach of ERISA fiduciary duty after employer stock significantly declined. The outcome of these cases varies widely.

Craig C. Martin & Elizabeth L. Fine, *ERISA Stock Drop Cases: An Evolving Standard*, 38 J. MARSHALL L. REV. 889, 901 (2005) (emphasis added).

Since then, in just 2006 to date, Petitioners are presently aware of decisions rendered in fourteen cases, aside from this case, in which the plaintiffs have alleged that an ERISA plan fiduciary breached its duty of prudence by failing to either diversify that plan's investment in employer stock or remove employer stock as an investment option. *See In re Aquila ERISA Litig.*, 2006 U.S. Dist. Lexis 49100 (W.D. Mo. July 18, 2006); *In re Merck & Co., Inc., Sec. Derivative and ERISA Litig.*, 2006 U.S. Dist. Lexis 53729 (D.N.J. July 11, 2006); *Rankin v. Rots*, 2006 U.S. Dist. Lexis 45706 (E.D. Mich. June 28, 2006); *DiFelice v. U.S. Airways, Inc.*, 436 F. Supp. 2d 756 (E.D. Va. 2006); *Edgar v. Avaya, Inc.*, 2006

U.S. Dist. Lexis 23151 (D.N.J. Apr. 24, 2006); *Smith v. Aon Corp.*, 2006 U.S. Dist. Lexis 27297 (N.D. Ill. Apr. 12, 2006); *In re GM ERISA Litig.*, 2006 U.S. Dist. Lexis 16782 (E.D. Mich. Apr. 6, 2006); *In re Cardinal Health, Inc. ERISA Litig.*, 424 F. Supp. 2d 1002 (S.D. Ohio 2006); *Smith v. Delta Airlines, Inc.*, 422 F. Supp. 2d 1310 (N.D. Ga. 2006); *In re RCN Litig.*, 2006 U.S. Dist. Lexis 12929 (D.N.J. Mar. 21, 2006); *In re Ferro Corp. ERISA Litig.*, 422 F. Supp. 2d 850 (N.D. Ohio 2006); *Rogers v. Baxter Int'l.*, 417 F. Supp. 2d 974 (N.D. Ill. 2006); *Sherrill v. Federal-Mogul Corp. Ret. Programs Comm.*, 413 F. Supp. 2d 842 (E.D. Mich. 2006); *In re Syncor ERISA Litig.*, 410 F. Supp. 2d 904 (N.D. Cal. 2006).

The issues raised in this petition for certiorari are the subject of massive ongoing litigation in the lower courts. The present split in the Circuits presents an opportunity for the Court to resolve that conflict, provide much-needed guidance to the lower courts, and promote efficient resolution of these and other cases presently pending within the federal system.

II. THE COURTS OF APPEALS ARE IN CONFLICT ABOUT THE EFFECT, IF ANY, THAT A FIDUCIARY'S STATUS AS A "DIRECTED TRUSTEE" UNDER 29 U.S.C. § 1103(a)(1) HAS ON THE DUTY TO DIVERSIFY AN ESOP'S INVESTMENT IN EMPLOYER STOCK

The Courts of Appeals are currently fractured as to how, if at all, the standard for determining when an ESOP's investments must be diversified applies when the fiduciary in question is a "directed trustee" acting pursuant to 29 U.S.C. § 1103(a)(1). In this case, the Seventh Circuit indicated that the same standard should apply to named fiduciaries (in this case, the UAL Corporation ESOP Committee) and directed

trustees (such as Respondent State Street). *See, e.g.*, 453 F.3d at 406-07. Petitioners believe the Seventh Circuit was correct on this point but misstated the applicable standard of liability, as noted above. However, Petitioners recognize that the Courts of Appeals differ on this issue and that the issue will likely have to be addressed in any opinion by this Court on the merits of this suit.

The Seventh Circuit made no distinction between the standard that applies to directed trustees and the standard that applies to named fiduciaries, although it acknowledged that other courts have found that there should be a distinction. *See id.* at 406. The court ruled that directed ESOP trustees have a duty of prudence under 29 U.S.C. § 1104(a)(1)(B), modified to reflect the fact that the duty to diversify does not generally apply to ESOP fiduciaries. *See id.*

However, the Seventh Circuit concluded that a directed ESOP trustee has a duty to reject imprudent directions from a named fiduciary because

> the directed trustee "shall be subject to the *proper* directions of [the named] fiduciary which are made in accordance with the terms of the plan and *which are not contrary to [ERISA].*" § 1103(a)(1) (emphasis added). An imprudent direction cannot be a proper direction since the trustee has an express statutory duty of prudence.

453 F.3d at 406. Thus, the court found that directed trustees therefore have a duty to "disobey the named fiduciary's directions when it is plain that they are imprudent." *Id.* at 407. Therefore, the court concluded, for a directed trustee "knowingly to invest [trust assets] imprudently or let them remain invested imprudently is irresponsible behavior for a trustee, whose fundamental duty is to take as much care with

trust assets as he would with his own property." *Id.* As a result, the Seventh Circuit formulated and applied its standard without drawing any distinction between the duties owed to an ESOP by directed trustees versus other fiduciaries. *See id.* at 407, 408, 410.

The Eighth Circuit, in one of its decisions on the issue, is largely in accord with the Seventh Circuit. In *First-Tier Bank, N.A. v. Zeller*, 16 F.3d 907, 911 (8th Cir. 1994), the court held that directed trustees are "not relieved of [their] duties to conform to the prudent man standard of care, 29 U.S.C. § 1104(a) [and] to attempt to remedy known breaches of duty by other fiduciaries. . . ."

A different decision from the Eighth Circuit and decisions by the Third and Eleventh Circuits are in conflict with the Seventh Circuit and the Eighth Circuit in *First-Tier.* In *Maniace v. Commerce Bank of Kansas City*, 40 F.3d 264, 268 (8th Cir. 1994), the court held that "[t]he obligations of a directed trustee are something less than that owed by typical fiduciaries" and concluded that the directed trustee had no "'residual' duties" that would require it to diversify the ESOP's investments. The Third and Eleventh Circuits have stated their views more concisely, albeit in *dicta* in cases that did not involve directed trustees. *See Moench*, *supra*, 62 F.3d at 571 (named "fiduciaries should not be immune from judicial inquiry, as a directed trustee essentially is"); *Herman v. NationsBank Trust Co.*, 126 F.3d 1354, 1361 (11th Cir. 1997) (a directed trustee "is not subject to the fiduciary requirement in § 1104(a) to act prudently").

Other Circuits have also touched on the issue, but have not clearly articulated applicable standards. In *Lalonde*, *supra*, 369 F.3d at 7, the First Circuit did not outline with specificity the fiduciary duties, if any, it believed an ESOP directed trustee owed to an ESOP, other than to hold that

"[i]t would subvert the purposes of ERISA to permit lawsuits against plan fiduciaries . . . every time a company's fortunes took a relatively unexceptional turn for the worse."

Similarly, in *Wright*, *supra*, 360 F.3d at 1102, the Ninth Circuit held that "directed trustees . . . cannot be held liable for following the investment instructions provided by a plan's fiduciaries." However, the court declined to reach the question of whether it would have been a breach of fiduciary duty for a directed trustee to follow instructions that it knew to be imprudent. *See id.*

To add to the considerable confusion already existing among the courts, in 2004 the Department of Labor issued a bulletin that sets forth its view on the fiduciary responsibility of a directed trustee to diversify an ESOP's investments. *See* U.S. Dept. of Labor, Field Assistance Bulletin No. 2004-03 (December 17, 2004) ("FAB No. 2004-03") (Pet. App. H). According to that bulletin, directed trustees who do not have non-public information have a duty to reject a fiduciary's direction to invest in employer stock only

> in limited, extraordinary circumstances, where there are clear and compelling public indicators . . . that call into serious question a company's viability as a going concern.

Id. at 5-6.

This standard has been at least nominally followed by several district courts. *See DiFelice v. U.S. Airways, Inc.*, 397 F. Supp. 2d 735, 751-52 (E.D. Va. 2005); *In re Worldcom, Inc., ERISA Litig.*, 354 F. Supp. 2d 423, 445-48 (S.D.N.Y. 2005); *In re RCN Litig.*, 2006 U.S. Dist. Lexis 12929, *13-16 (D.N.J. Mar. 21, 2006). The Seventh Circuit is the only Court of Appeals to address the standard set forth in FAB 2004-03. In doing so (in this case), that court concluded that

the DOL's guidance "is not an administrable standard" and that it would require diversification by a directed trustee only when it "will almost certainly be too late." 453 F.3d at 411.

The Seventh Circuit is correct on that point, and is furthermore correct that the same standard of liability should apply to all ESOP fiduciaries, whether they are directed trustees or not. ERISA expressly contemplates that directed trustees are not immune from liability if they follow instructions that are "contrary to" the statute. 29 U.S.C. § 1103(a)(1). Thus, if a named fiduciary gives an instruction to a trustee that is imprudent under ERISA, the trustee may be held liable for following that instruction – especially if, as is in this case, the trustee has reason to suspect that the instruction is imprudent.

That reading of the statute is bolstered by the fact that any fiduciary, including a directed trustee, can be held liable if he knows that another fiduciary has committed a breach but takes no action to remedy that breach. *See* 29 U.S.C. § 1105(a)(3). This basic requirement is undercut, or simply ignored, by the approach of the Third and Eleventh Circuits, which would apparently allow a directed trustee to avoid liability for failing to divest an ESOP's investments, even when it was imprudent for the named fiduciary to invest them as such. A directed trustee should be held to the same duty as a named fiduciary, or else directed trustees will avoid liability for following investment instructions that violate ERISA's standard of prudence.

Any other standard would provide a directed trustee with excessive and unwarranted protection from liability. Indeed, under even the *Moench* standard, all ESOP fiduciaries are already entitled to a ***presumption*** that an investment in employer stock is prudent. *See* 62 F.3d at 571. To provide an additional layer of protection to directed trustees for

investments in employer stock would essentially render them "immune from judicial inquiry." *See id.* That cannot, and should not, be the case where, as in this case, the trustee (1) had access to repeated public statements from the company and third-party sources that the company was at significant risk of bankruptcy, (2) knew that the risk of investing in the company had increased significantly, as demonstrated by the company's massive cash losses and inability to retain financing, (3) was so concerned about the company's viability that it monitored the company's financial health for months, (4) knew that the other fiduciaries had not even discussed the company's financial health, and (5) did nothing to protect the ESOP's assets until the stock had already lost the vast majority of its value. At an absolute minimum, such facts should raise genuine issues of material fact as to such a trustee's liability for failing to diversify the ESOP's investments.

The Court should grant certiorari in order to resolve the significant Circuit split on these issues and to set the proper standard for fiduciary and directed-trustee liability for failure to diversify an ESOP's investments.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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